No. 9463

In the United States Circuit Court of Appeals for the Ninth Circuit

Albert K. Miller, petitioner

v.

Commissioner of Internal Revenue, respondent

ON PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

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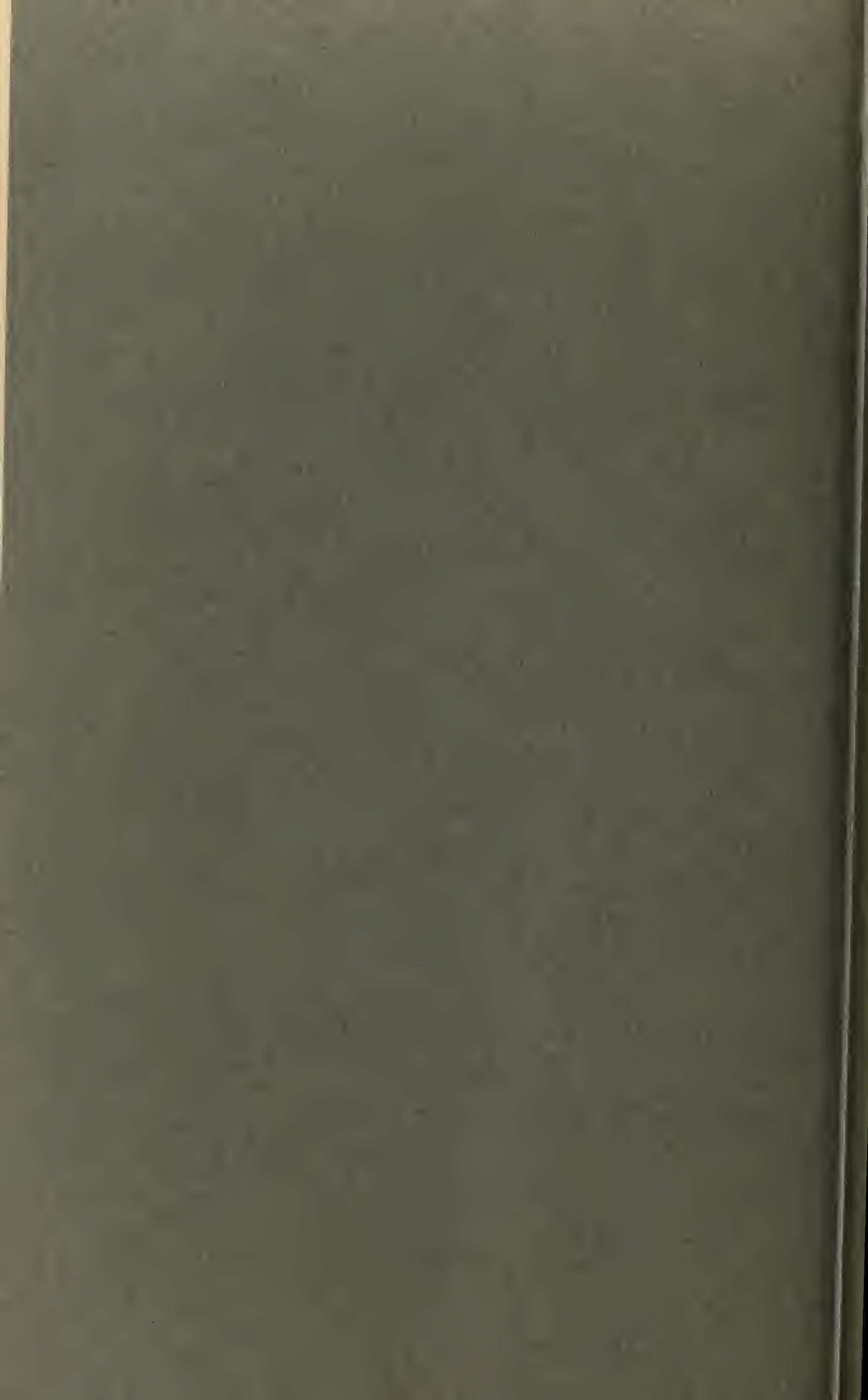

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The only previous opinion in this case is that of the United States Board of Tax Appeals, promulgated September 6, 1939 (R. 14–19), which is reported in 40 B. T. A. 514.

JURISDICTION

This appeal involves federal income taxes for the calendar year 1933 in the sum of $2,202.80 and is taken from a decision of the Board of Tax Appeals entered October 26, 1939. (R. 19–20.)

The case is brought to this Court by a petition for review filed by the petitioner on January 24, 1940 (R. 20–26), pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTION PRESENTED

Is Section 218 (a) of the National Industrial Recovery Act, which repealed Section 117 of the Revenue Act of 1932, unconstitutional, thus permitting the petitioner to bring forward in the taxable year 1933 a net loss sustained in 1932?

STATUTES INVOLVED

The statutes involved are set forth in the Appendix, *infra*, pp. 14–15.

STATEMENT

The material facts as found by the Board of Tax Appeals (R. 15) are as follows:

The petitioner is a resident of San Francisco, California, and filed his income tax return for the year 1933 with the Collector at that city. During the calendar years 1932 and 1933, petitioner was engaged in business as a trader in securities listed on various stock exchanges in the United States. During the calendar year 1932 petitioner sustained a net loss, attributable to the operation of his business, in the amount of $63,426.02, which he brought forward and claimed as a deduction from gross income in his income tax return for the year 1933 under Section 117 of the Revenue Act of 1932. (R. 15.)

The Commissioner, in determining the deficiency, disallowed the amount of $63,226.02 instead of the full amount claimed by the petitioner on his return. Claim was duly made by the Commissioner for the increased deficiency in tax resulting from the disallowance of the full amount of $63,426.02 instead of $63,226.02. (R. 15.)

The Commissioner disallowed the deduction on the ground that, since Section 117 of the Revenue Act of 1932 had been specifically repealed by Section 218 (a) of the National Industrial Recovery Act, effective as of January 1, 1933, petitioner could not deduct in 1933 a net loss brought forward from 1932. The Board of Tax Appeals affirmed the determination of the Commissioner. (R. 15–16, 19.)

SUMMARY OF ARGUMENT

In his tax return for the calendar year 1933 petitioner claimed a deduction for a net loss sustained in 1932, under Section 117 of the Revenue Act of 1932. If Section 117 had been in effect during the year 1933, petitioner would have been entitled to deduct a net loss for 1932 determined as provided in that section. But that section was not in effect during the year 1933. Section 218 (a) of Title II of the National Industrial Recovery Act repealed Section 117 of the Revenue Act of 1933 and expressly provided that the repeal should take effect as of January 1, 1933. It is obvious that a deduction may not be claimed for which there is no statutory authority.

Petitioner's principal argument is that Section 218 (a) fell when Title I of the National Industrial Recovery Act was held unconstitutional in *Schechter Corp.* v. *United States,* 295 U. S. 495, and, therefore, Section 117 of the Revenue Act of 1932 was still in effect during the calendar year 1933. It is submitted the contention is without substantial merit. The National Industrial Recovery Act contains a separability clause, Section 303, *infra.* This clause is an explicit declaration showing the intent of Congress that the invalidity of one

section of the Act shall not affect the others. Furthermore, the National Industrial Recovery Act contains many provisions relating to entirely different and independent matters. Section 218 (a), here involved, in no matter related to or depended upon the codes of fair competition involved in the Schechter decision. Thus the two essentials for separability are present and under numerous decisions of the Supreme Court the provision herein pertinent must be deemed to be valid and effective as repealing Section 117 of the Revenue Act of 1932.

Neither is Section 218 (a) invalid because retroactive from the date of its enactment (June 16, 1933) to January 1, 1933. It is generally recognized and has been repeatedly held that such retroactivity in income tax statutes does not violate the due process clause or any inherent rights of taxpayers. Also, it will be noted that here Congress only revoked a privilege it had given previously. This was within the legislative power of Congress and only by a strained construction of the repealing provision, for which there is no authority, may it be argued that the repeal is not effective for the year 1933 but only subsequent to that year.

ARGUMENT

I

There is no statutory authority for the allowance of a deduction in the petitioner's income tax return for 1933 for a net loss sustained in 1932

In his income tax return for the calendar year 1933, the petitioner claimed a deduction of $63,426.02 for a net loss sustained in 1932 under Section 117 of the

Revenue Act of 1932, *infra.* If Section 117 of the Revenue Act of 1932 had been in effect during the year 1933, petitioner would have been entitled to deduct a net loss for 1932 determined as provided in that section.[1] But that section was not in effect during the year 1933. Section 218 (a) of Title II of the National Industrial Recovery Act, *infra,* repealed Section 117 of the Revenue Act of 1932 and specifically provided that the repeal should take effect as of January 1, 1933. It is obvious that a deduction may not be claimed for which there is no statutory authority.

Petitioner claims that Section 117 of the 1932 Act was still effective for the purpose of carrying over a net loss into 1933, and his principal argument in support of such position is that Section 218 (a) was unconstitutional.

II

Section 218 (a) of Title II of the National Industrial Recovery Act is not unconstitutional

Petitioner challenges Section 218 (a) on the ground that this provision fell when Title I of the National Industrial Recovery Act was held unconstitutional in *Schechter Corp.* v. *United States,* 295 U. S. 495. We submit that the contention is without substantial merit.

The discussion in petitioner's brief (pp. 7–9) as to improper delegation of power by Congress to the President has no application to Section 218 (a). No

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[1] It has been stipulated that if the disallowance of the net loss was correct, the proper amount to be disallowed is $63,426.02 instead of $63,226.02, the amount which the Commissioner disallowed, and that the claim of the Government for an increased deficiency should be allowed. (R. 13, 15.)

authority was vested in the President as to whether or not the repeal of the designated sections of the Revenue Act of 1932 should take effect. Such repeal took effect upon enactment of the Act.

Petitioner's main argument rests on the ground that the Supreme Court in the *Schechter* case, *supra,* declared the entire National Industrial Recovery Act unconstitutional. It is asserted that Section 218 (a) of that Act can not be severed from the whole Act and that such Section fell with the provisions of Title I of the National Industrial Recovery Act which were considered by the Court in the *Schechter* case.

An examination of the provisions of the National Industrial Recovery Act discussed by the Supreme Court in the *Schechter* case discloses that this argument is wholly without support.

It should be noted that the National Industrial Recovery Act contains the usual separability clause. See Section 303, *infra.* The effect of such a clause in a statute is to create a presumption that the legislature did not intend the statute to be an integrated whole which, as such, must be sustained or held invalid. *Electric Bond Co.* v. *Comm'n,* 303 U. S. 419, 434; *Williams* v. *Standard Oil Co.,* 278 U. S. 235, 242; *Champlin Rfg. Co.* v. *Commission,* 286 U. S. 210, 235; *Sonzinsky* v. *United States,* 300 U. S. 506. Here, as in the *Electric Bond* case, there is an explicit declaration to the contrary and accordingly, the inquiry must be whether Section 218 (a) of Title II is so interwoven with Title I, held invalid in the *Schechter* case, that the presumption of separability is overcome.

The National Industrial Recovery Act consists of three titles: Title I "Industrial Recovery", Title II, "Public Works and Construction Projects", and Title III, "Amendments to Emergency Relief and Construction Act and Miscellaneous Provisions." The provision held unconstitutional in the *Schechter* case was Section 3, Title I, which related to the establishment of codes of fair competition for industry. The Court held the provision unconstitutional on the ground that it involved an unconstitutional delegation of legislative power to the President and represented an attempt to regulate matters within the control of the states.

Section 218 (a) with which we are concerned has no relation to the legislation concerning codes of fair competition found in Title I of the Act. The provision is contained in Title II under a separate subheading "Employment and Relief Taxes". Under that subheading are found various taxing provisions. Thus Section 211 increased the excise tax imposed on the sale of gasoline; Section 212 extended certain excise taxes imposed under the Revenue Act of 1932; Section 213 imposed an excise tax on corporate dividends; Sections 215 and 216 imposed related capital stock and excess profits taxes; and Sections 217, 218 and 219 contained various amendments and provisions all of which related to taxes. Thus Section 218 (a), which is said to be inseparable and incapable of being sustained, is found among provisions designed to affect revenues to be collected.

Sections 211–219 had no relation to the regulatory features of Title I. As the provisions indicated they

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are collected under the subheading "Employment and Relief Taxes" under Title II dealing with such works and construction projects. There the obvious purpose was to raise additional revenue for relief and public works expenditures. Under Section 220 of Title II Congress authorized the sum of $3,300,000,000 to be appropriated for those purposes. To meet these vast expenditures Congress found it necessary to enact the revenue provisions set forth in Sections 211–219. They have been administered ever since their enactment, both prior and subsequent to the *Schechter* decision, millions of dollars in revenue have been collected under them and only in a few instances has it even been suggested that their validity was affected by the invalidity of Title I. And where the suggestion has been made, it has been repudiated and rejected.

In *Allied Agents* v. *United States,* 26 F. Supp. 98, the Court of Claims held that the validity of the taxes imposed by Title II was not affected by the decision in the *Schechter* case. The Board of Tax Appeals has consistently applied the same rule. See *W. & K. Holding Corp.* v. *Commissioner,* 38 B. T. A. 830; *A. J. Crowhurst & Sons, Inc.* v. *Commissioner,* 38 B. T. A. 1072; *Cereal Products Refining Corp.* v. *Commissioner,* 39 B. T. A. 92.

We think also that the separability of the provisions of the National Industrial Recovery Act has been implicitly recognized by the Supreme Court itself. Thus in the case of *Duke Power Co.* v. *Greenwood Co.,* 302 U. S. 485, the Court held provisions contained in Title II, relating to loans for public works projects, valid, though it previously held Title I unconstitutional

in the *Schechter* case. Moreover, even before the *Schechter* case was decided, certain provisions contained in Section 9 of Title I had been held invalid in *Panama Refining Co.* v. *Ryan,* 293 U. S. 388. If the Court had considered those provisions inseparable from Section 3 of Title I, involved in the *Schechter* case, it would have disposed of the latter very simply without discussing separately the constitutional problems presented by Section 3. Instead, however, the Court dealt with the question of constitutionality of Section 3 as a distinct problem.

From an examination of the various subjects included in and dealt with by the National Industrial Recovery Act, it will be seen that all of its provisions are not so combined and welded as to be incapable of severance without destructive mutilation of each and all. Quite the contrary is true. The provisions relating to the collection of the revenue do not depend for their effect or validity upon other provisions relating to public works or codes of fair competition. The preamble of the Act itself provides that it is an Act "To encourage national industrial recovery, to foster fair competition, and to provide for the construction of certain useful public works, *and for other purposes.*" [Italics supplied.] Title III refers to matters of emergency relief, construction and finance activities, and miscellaneous provisions, all of which are unrelated to the codes of fair competition contemplated by Title I. From the foregoing it is entirely clear that the two essentials for separability—the intent of the legislature and the fact that some provisions standing

alone may be given effect without others—are present in the National Industrial Recovery Act.

Applying the principles frequently announced and reiterated by the Supreme Court, we submit there is no real doubt that the revenue provision here involved is not invalid by reason of the action of the Supreme Court in declaring invalid the provisions relating to codes of fair competition in the *Schechter* case. See *Lynch* v. *United States,* 292 U. S. 571, 586; *Carter* v. *Carter Coal Co.,* 298 U. S. 238, 312; *Sonzinsky* v. *United States, supra.*

III

The statutory provision here involved is not unconstitutional because retroactive

Petitioner further attacks Section 218 (a) on the ground that it is retroactive and therefore violates the Fifth Amendment. It is true that the National Industrial Recovery Act was enacted June 16, 1933, and that Section 218 (a) repealed Section 117 of the Revenue Act of 1932 as of January 1, 1933. But any argument that this limited retroactivity constitutes a violation of the Fifth Amendment is foreclosed by a long line of decisions of the Supreme Court.

The income tax titles of all of the revenue acts have been retroactive in the sense that they have prescribed rules for the determination of income and deductions and the collection of taxes with respect to transactions for a period prior to passage of the Acts. And this retroactivity has been upheld as not constituting a violation of the due process clause of the Fifth Amendment. *Brushaber* v. *Union Pac. R. R.,* 240 U. S. 1;

Lynch v. *Hornby,* 247 U. S. 339; *Cooper* v. *United States* 280 U. S. 409; *Taft* v. *Bowers,* 278 U. S. 470; *Fawcus Mach. Co.* v. *United States,* 282 U. S. 375; *Brown & Sons Co.* v. *Burnet,* 282 U. S. 283; *Graham & Foster* v. *Goodcell,* 282 U. S. 409; *Phillips* v. *Commissioner,* 283 U. S. 589; *Reinecke* v. *Smith,* 289 U. S. 172; *Burnet* v. *Wells,* 289 U. S. 670. The Supreme Court stated recently in the case of *United States* v. *Hudson,* 299 U. S. 498, as follows (p. 500):

> As respects income tax statutes it long has been the practice of Congress to make them retroactive for relatively short periods so as to to include profits from transactions consummated while the statute was in process of enactment, or within so much of the calendar year as preceded the enactment; and repeated decisions of this Court have recognized this practice and sustained it as consistent with the due process of law clause of the Constitution.

The cases cited by the petitioner in support of his contention are not in point and do not deal with the precise question of retroactivity here involved. Cf. *Nichols* v. *Coolidge,* 274 U. S. 531; *Untermyer* v. *Anderson,* 276 U. S. 440; *Coolidge* v. *Long,* 282 U. S. 582; *Milliken* v. *United States,* 283 U. S. 15. These cases, in the main, deal with transfers of property intended to take effect in possession or enjoyment at a time prior to the time upon which the revenue acts involved purported to lay a tax and in them the Court held that if the statutes were to be construed as applicable to transfers fully consummated before their enactment, they would be so arbitrary and capricious as

to amount to confiscation and, therefore, void. But the wide application of this principle recently has been severely restricted by the Supreme Court in the class of cases involving exactions upon transfers. *Helvering* v. *Hallock,* 308 U. S. 532. Also, the authorities cited by petitioner deal exclusively with estate tax questions. In no case, analogous to the case at bar, has an income tax statute been declared void because of retroactivity.

In any event, the question here is not the same. Petitioner is claiming the right to a deduction. It is well established that taxpayers have no inherent or vested rights to deductions. The allowance of deductions from gross income for the purpose of determining taxable income is a matter of "legislative grace." *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440; *Helvering* v. *Ind. Life Ins. Co.,* 292 U. S. 371. Here, Congress only revoked a privilege it had given previously. This was within the legislative power of Congress. In the light of well settled principles, illustrated in the above cited cases, the retroactivity here involved clearly infringed no right, constitutional or otherwise, of the petitioner.

Likewise, there is no support for petitioner's contention that Section 218 (a) is not applicable to the calendar year 1933. The legislative history of the provision cited by petitioner (Br. 25) clearly shows that Congress was only removing a privilege granted by a prior statute. The term "subsequent year" refers to the year succeeding that in which the loss actually occurred and in which the deduction was allowable, if

not repealed. The language clearly does not refer to the year subsequent to the actment of the Act and only through a strained construction can such a result be reached. In any event, since the privilege may be granted or removed by Congress at will, the plain language of the statute repealing the earlier provisions will be followed rather than a construction based upon the so-called "right" of the taxpayer. Manifestly, the action of Congress in removing a privilege theretofore granted may not be said to be arbitrary and capricious or to result in gross and patent inequalities. *George W. Helme Co.* v. *United States,* 23 F. Supp. 787 (C. Cls.).

CONCLUSION

The decision of the Board of Tax Appeals is correct and should be affirmed.

Respectfully submitted,

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May, 1940.

APPENDIX

Statutes Involved

Revenue Act of 1932, c. 209, 47 Stat. 169:

Sec. 117. Net Losses.

(a) *Definition of "Net Loss."*—As used in this section the term "net loss" means the excess of the deductions allowed by this title over the gross income, with the following exceptions and limitations:

(1) *Non-Business Deductions.*—Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall be allowed only to the extent of the amount of the gross income not derived from such trade or business;

(2) *Capital Losses.*—In the case of a taxpayer other than a corporation, deductions for capital losses otherwise allowed by law shall be allowed only to the extent of the capital gains;

(3) *Depletion.*—The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value, or to percentage depletion under section 114 (b) (3) or (4);

(4) *Dividends.*—The deduction provided for in section 23 (p) of amounts received as dividends shall not be allowed;

(5) *Interest.*—There shall be included in computing gross income the amount of interest received free from tax under this title, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b);

(6) *Net Loss not to Produce Net Loss.*—In computing the net loss for any taxable year a

net loss for a prior year shall not be allowed as a deduction.

(b) *Net Loss as a Deduction.*—If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called "second year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

(c) *Capital Net Gain in Second Year.*—If in the second year the taxpayer (other than a corporation) has a capital net gain, the deduction allowed by subsection (b) of this section shall first be applied as a deduction in computing the ordinary net income for such year. If the deduction is in excess of the ordinary net income (computed without such deduction) the amount of such excess shall then be applied against the capital net gain for such year.

National Industrial Recovery Act, c. 90, 48 Stat. 195, Title II:

Sec. 218 (a). Effective as of January 1, 1933, Sections 117, 23 (i), 169, 187 and 205 of the Revenue Act of 1932 are repealed.

* * * * *

(U. S. C., Title 26, Sec. 55.)

Title III:

Sec. 303. If any provision of this Act, or the application thereof to any person or circumstances, is held invalid, the remainder of the Act, and the application of such provision to other persons or circumstances, shall not be affected thereby. (U. S. C., Title 15, Sec. 711.)

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